Submission #1

Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017

Introduction

Superannuation funds are established as trusts which are administered by natural person trustees or a corporate trustee.

The Trust Deed that constitutes the trust will confer a power on a person or persons to remove and appoint the natural person trustees or corporate trustee.

Where a corporate trustee is appointed to administer the superannuation trust, the articles of association will confer a power on a person or persons to remove and appoint the directors of the corporate trustee.

In the case of a public company the members (ie shareholders) hold the power to remove and appoint the directors of the company.

The directors of a public company can be classified as:

(i) Executive Directors; and
(ii) Non-executive Directors.

In his Second Reading Speech Senator McGrath {Assistant Minister to the Prime Minister} said:

> "The Government believes that all superannuation members have a right to expect high standards of governance, enshrined in the law, including independent thinking and judgement that is free from conflict of interest underpinning how their money is managed."

In the case of public companies, executive directors, generally have a bonus scheme that precludes "***independent thinking and judgement***" - they are paid to focus on increasing the profitability of the company and returns to shareholders.

What about "*non-executive*" directors?

It is common practice for non-executive directors to hold shares in the company. Therefore these directors cannot really be classified as "***independent***".

However shareholders are likely to consider directors with some "***skin in the game***" to be more committed to how the company is being managed compared to directors who own no shares and who just turn up once a month for a nice luncheon to collect their director fees!

There is no case for a company director who is truly "***independent***" being a better director that one who has a financial interest in the company.

In any event it is the shareholders who judge the performance of the directors whether they be "***independent***" or may have a "*conflict of interests*".

It is the members (shareholders) whose money is at risk at the end of the day.

This is the first priority of any governance model.

Governance of Superannuation Funds

There are two types of superannuation funds:

(i) **Defined Contribution**; and
(ii) Defined Benefit

In ***Defined Contribution*** fund it is the fund members who bear the investment risk and thus are in a similar position to members of public companies.

In ***Defined Benefit*** funds it is the sponsoring employer who bears the investment risk.

The sponsoring employer therefore has a valid claim to have some employer nominated directors sitting on the board of a corporate trustee of a **Defined Benefit** fund.

In the case of a **Defined Contribution** fund the case can be made that all directors should be elected by the fund members, just as members of public companies elect directors.

This is especially the case when the fund is a '***for-profit'*** fund where the directors of the corporate trustee have a blatant conflict of interests. The parent bank or financial institution holds the power to remove and appoint the directors of the corporate trustee.

The Explanatory Memorandum states

> 1.8 Governance standards have been strengthened in relation to ASX listed entities as well as other prudentially supervised industries such as banking and insurance. An absence of any minimum requirement for independent directors means the superannuation industry has fallen behind standards that apply to other entities.

However this confuses the term "***non-executive***" director with the term "***independent***" director.

There may be a requirement for a minimum number of "***non-executive***" directors, however there is no ban on these directors owning shares in the company – hence they cannot be properly described as "***independent***", even though the word is loosely applied to non-executive directors.

No mention is made of the fact that in the case of ASX listed entities it is the members (shareholders) who hold the power to remove and appoint all the directors whatever label might be applied to them.

Summary of new law

1.11 Schedule 1 to this Bill amends the SIS Act to require trustees of registrable superannuation entities (RSEs) (commonly referred to as RSE licensees) that have a board of trustees to have a minimum of one-third independent directors including an independent Chair. The Bill also amends the SIS Act to require RSE licensees that are a group of individual trustees to have at least one-third of the trustees that are independent.

2.2 This Schedule introduces a definition of ***independent***. The new definition excludes individuals with a current or recent relationship with the RSE licensee or related bodies corporate and organisations representing employer sponsors and members.

But whose money is on the line in a superannuation fund?

Employers are required to contribute 9.5% of their employees' salary to a superannuation fund and fund members can make additional voluntary contributions.

In the case of ***Defined Contribution*** funds it is the members who bear the investment risk.

In the case of ***Defined Contribution*** funds it is the sponsoring employer who bears the investment risk.

However this Bill proposes to exclude any director who represents the interests of fund members or employers!

Furthermore the so called "***independent***" director cannot be a member of the fund

Where is the logic for people controlling an organisation when they have no "***skin in the game***".

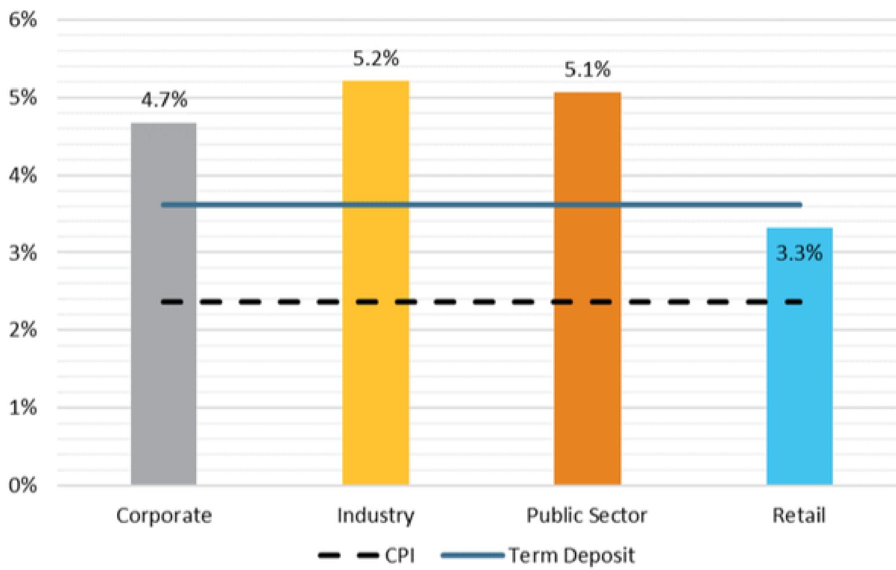
This is completely counter to the governance model of an ASX listed entity that is being used as a model to promote this Bill.

Where is the Empirical Evidence?

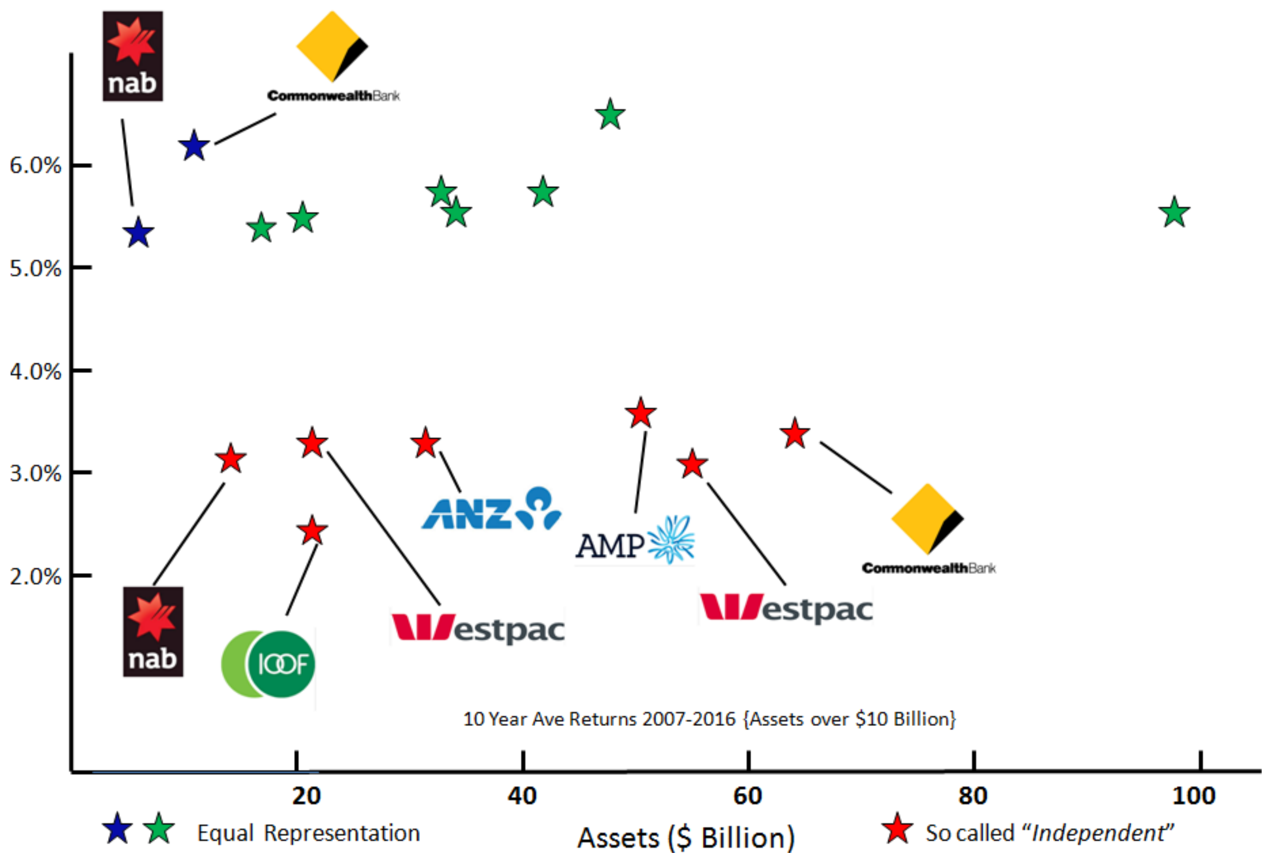
If directors who can be labelled "***independent***" are better than other types of directors where is the empirical evidence to justify the amendments proposed by this Bill?

From a member's perspective if the employer's and member's contributions while in the workforce amount to $X then the member would expect the retirement benefit $Y to be **as high as possible**, subject to a prudent risk exposure.

The long term average sectoral returns are illustrated in the following diagram.



However it is more instructive to look at similar sized funds and the governance model of the trustees of these funds based on ***APRA*** data.



The "***equal representation***" governance model consistently provides superior member outcomes compared to the so called "***independent***" governance model.

A member of a fund whose trustee is governed by the "***equal representation***" model will typically receive a retirement benefit around **30% more** than a member of a fund governed by the "***independent***" governance model.

All the "***motherhood***" statements about so called "***independent"*** directors cannot be substantiated by any empirical evidence.

IMPORTANT: Note the stellar returns of bank operated superannuation funds who have adopted the "***equal representation***" governance model.

Governance Reform

If governance reform is required, it is the governance model of '***for-profit'*** superannuation funds.

In a compulsory superannuation system the question must be asked:

> "Why are '***for-profit'*** superannuation funds allowed to participate in the first place?"

It is simple mathematics that any profit-taking will reduce final returns to fund members.

All the directors of '***for-profit'*** superannuation funds are appointed by the parent financial institution. Applying a phoney label like "***independent***" does not disguise this fact.

These directors do the bidding of the parent financial institution.

In the ***APRA*** submission to the Productivity Commission report "***Superannuation: Alternative Default Models***" (March 2017), Mrs Helen Rowell, the Deputy Chairman of ***APRA*** stated:

> "Governance has long been, and will continue to be, a key focus for APRA in discussions with all APRA-regulated industries, and superannuation is no exception.
>
> **All trustees are obliged to act in the best interests of their members, regardless of their business model.** That means that directors of retail (or so-called for-profit) trustees must seek to ensure the delivery of appropriate member outcomes – high quality, value for money benefits and services - notwithstanding the potential conflicts that may arise from the profit objectives of their parent entity."

Therefore ***APRA*** has acknowledged the conflict of interest faced by the directors of "***for-profit***" superannuation funds.

> "...a person in a fiduciary capacity must not make a profit out of his trust which is part of a wider rule that a trustee must not place himself in a position where his duty and interest may conflict."
>
> ***Phipps v Boardman*** [1967] 2 A.C. 46 at 123 per Lord Upjohn

Recommendation

The ***Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017*** should be voted down in the Senate.

Instead of appointing directors who represent no one on the boards of '***not-for-profit'*** funds, the governance of '***for-profit'*** superannuation funds should be improved by implementing the following governance model:

- One third of directors representing fund members;
- One third of directors representing employer organisations;
- One third of directors nominated by the parent financial institution.

This submission has been lodged by Phillip Charles Sweeney in the public interest so that the retirement outcomes of half of all working Australians can be increased by around 30% on average by a well consider change to the governance model of '***for-profit'*** superannuation funds.